



**MICHIGAN'S
ECONOMIC OUTLOOK
AND BUDGET REVIEW**

**FY 2002-03 AND FY 2003-04
REVISED**

October 13, 2003



EXECUTIVE SUMMARY

Economic Forecast

- The U.S. economy, as measured by inflation-adjusted gross domestic product, will increase at an estimated rate of 2.5% in 2003 and 3.9% in 2004. Light vehicle sales will total 16.6 million units in 2003 and rise to 16.8 million units in 2004. The unemployment rate will rise from 6.1% in 2003 to 6.2% in 2004.
- The Michigan economy, as measured by inflation-adjusted personal income, will increase at an estimated rate of 0.9% in 2003 and 2.0% in 2004. Wage and salary employment will decline 1.1% in 2003 and increase by 0.7% in 2004.

Revenue Estimates

- General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenues will total \$18.56 billion in fiscal year (FY) 2002-03, which is down \$289 million from the May 2003 consensus estimate. In FY 2003-04, GF/GP and SAF revenues will total an estimated \$18.32 billion, which is \$592 million below the May estimate.
- GF/GP revenue will total an estimated \$7.89 billion in FY 2002-03 and \$7.78 billion in FY 2003-04. Compared with the May 2003 consensus estimate, these revised estimates are down \$197 million and \$381 million, respectively.
- SAF revenue from earmarked taxes and the lottery is expected to total \$10.67 billion in FY 2002-03 and \$10.54 billion in FY 2003-04. These estimates represent downward revisions from the May consensus estimates of \$91 million and \$211 million, respectively.

Year-End Balances Estimates

- The GF/GP budget will close FY 2002-03 with a \$48 million surplus, which is down from the previous estimate of a \$360 million surplus. Based on the revised revenue estimates and the enacted appropriations for FY 2003-04, it is estimated that the FY 2003-04 GF/GP budget is in deficit by \$585 million.
- The SAF budget will close FY 2002-03 with an estimated deficit of \$90 million, which will have to be carried over into FY 2003-04. For FY 2003-04, the combination of the carryover deficit from FY 2002-03, the downward revision in the SAF revenue estimate, and the level of enacted appropriations, translates into an SAF deficit of an estimated \$318 million.

THE ECONOMIC REVIEW AND OUTLOOK

State revenues, particularly taxes, depend heavily on economic conditions. This section presents the Senate Fiscal Agency's latest economic forecast for 2003 and 2004, as well as a summary of recent economic activity.

RECENT ECONOMIC HIGHLIGHTS

Both the U.S. and Michigan economies experienced a significant economic slowdown during 2001 and 2002, ending the record economic expansion that began in 1991. According to the National Bureau of Economic Research (NBER), traditionally regarded as the authority for dating stages of the business cycle, the U.S. economy entered a recession in March 2001. In July 2003, the NBER announced the recession ended in November 2001, although job growth and many economic indicators have remained low or even at recessionary levels. While inflation-adjusted Gross Domestic Product (GDP) grew at an average annual rate of approximately 2.7% between the fourth quarter of 2001 and the second quarter of 2003, wage and salary employment declined at an average rate of 0.5%. The unemployment rate rose from 4.0% in 2000, the lowest level since 1969, to 6.4% in June 2003, the highest level since April 1994. Light vehicle sales fell from an annual rate of 18.1 million units in the first quarter of 2000 to 15.8 million units during the first quarter of 2003.

Michigan's economy, particularly the Michigan job market, declined even more drastically than the national economy. Michigan wage and salary employment peaked in June 2000, nine months before the national recession began. As of August 2003, Michigan wage and salary employment remained in decline. Between the fourth quarter of 2001, when the national recession officially ended, and August 2003, the Michigan economy lost 113,000 jobs—the most lost by any state in the nation. The employment loss represents a 2.50% decline in employment since the fourth quarter of 2001 and only Missouri experienced a larger decline in employment, at 2.54%. These large employment declines continued into 2003. Compared with other states, Michigan reported the largest percentage decline in employment, as well as the largest decline in the number of people employed, between July and August 2003. As of August 2003, the decline in Michigan wage and salary employment since the fourth quarter of 2001 represented 23.5% of the total decline in wage and salary employment reported nationally. In comparison, Michigan wage and salary employment comprises only 3.3% of U.S. wage and salary employment.

Inflation-adjusted Michigan personal income grew at an average annual rate of 2.1% between the second quarter of 2002 and the first quarter of 2003. The seasonally adjusted Michigan unemployment rate rose from 3.1% in the first quarter of 2000, the lowest level since 1966, to 7.4% in July and August of 2003, the highest level since January 1993. Adjusted for seasonality, the Michigan economy lost approximately 276,000 jobs between April 2000 and August 2003, an amount equivalent to 5.4% of the August 2003 labor force. Inflation remained moderate in 2001 and 2002, with prices rising only 2.7% and 2.6%, respectively, largely due to declines in energy prices as well as the general weakness in the economy.

The economy slowed substantially in response to a number of conditions that will continue to affect the economy through the remainder of 2003 and into 2004. The primary risks facing the economy over the next two years reflect: 1) wealth effects of slow growth, or even declines, in asset values; 2) declines or weak growth in business and consumer confidence; 3) consumption growth being hampered by high debt burdens, particularly once interest rates begin rising; 4) production overcapacity; and 5) weak growth in exports. These factors were discussed in more detail in the Senate Fiscal Agency's (SFA's) May 2003 Budget Status Report.

FORECAST SUMMARY

Both the U.S. and Michigan economies are expected to grow in 2003 and 2004, and at a higher rate than in recent years (see [Figure 1](#)). [Table 1](#) and [Table 2](#) provide a summary of key economic indicators from the SFA's economic forecast, with references to recent years. Inflation-adjusted GDP is projected to grow by 2.5% in 2003 and 3.9% in 2004, after rising 2.4% in 2001. Most of the growth is expected to be fueled by growth in consumer spending, as consumers take advantage of stimulative monetary and fiscal policy and low inflation. Government expenditures will contribute little to economic activity in 2004 as large boosts in spending and additional tax reductions are not expected to occur. Business will begin to build inventories and increase investment in the fourth quarter of 2003. The unemployment rate will increase slightly at the end of 2003 and remain stable through the first half of 2004, before declining to 6.0% in the final quarter of 2004.

Table 1

THE SENATE FISCAL AGENCY ECONOMIC FORECAST					
(Calendar years)					
	2000	2001	2002	2003	2004
<u>United States</u>	Actual	Actual	Actual	Estimate	Estimate
Nominal GDP (year-to-year growth)	5.9%	2.6%	3.6%	4.0%	5.5%
Inflation-adjusted GDP (year-to-year growth)	3.8%	0.3%	2.4%	2.5%	3.9%
Unemployment rate	4.0%	4.7%	5.8%	6.1%	6.2%
Inflation					
Consumer Price Index (year-to-year growth)	3.3%	2.8%	1.6%	2.4%	1.9%
GDP Implicit Price Deflator (year-to-year growth)	2.1%	2.4%	1.1%	1.5%	1.5%
Interest rates					
90-day Treasury Bill	5.85%	3.45%	1.62%	1.02%	1.66%
Corporate Aaa bond	7.62%	7.08%	6.49%	5.73%	5.53%
Federal Funds Rate	6.24%	3.88%	1.67%	1.13%	1.50%
Light Motor Vehicle Sales (millions of units)	17.2	17.0	16.7	16.6	16.8
Auto	8.9	8.4	8.1	7.7	7.7
Truck	8.4	8.6	8.6	8.8	9.1
<u>Michigan</u>					
Personal Income (millions)	\$292,786	\$296,481	\$303,745	\$313,764	\$325,737
year-to-year growth	6.0%	1.3%	2.5%	3.3%	3.8%
Inflation-adjusted personal income (year-to-year growth)	2.3%	-1.4%	-0.1%	0.9%	2.0%
Wage & salary income (millions)	\$175,593	\$173,299	\$173,529	\$177,768	\$182,419
year-to-year growth	5.4%	-1.3%	0.1%	2.4%	2.6%
Detroit Consumer Price Index (year-to-year growth)	3.6%	2.7%	2.6%	2.4%	1.7%
Wage & Salary Employment (thousands)	4,673.9	4,555.9	4,476.5	4,429.0	4,459.2
year-to-year growth	2.0%	-2.5%	-1.7%	-1.1%	0.7%
Unemployment Rate	3.5%	5.3%	6.2%	7.1%	7.1%

Table 2

THE SENATE FISCAL AGENCY U.S. ECONOMIC FORECAST DETAIL (Calendar years)					
	2000 Actual	2001 Actual	2002 Actual	2003 Estimate	2004 Estimate
Gross Domestic Product (billions of dollars)	\$9,824.6	\$10,082.2	\$10,446.2	\$10,863.3	\$11,457.0
year-to-year growth	5.9%	2.6%	3.6%	4.0%	5.5%
<u>Inflation-Adjusted GDP and Components</u>					
Gross Domestic Product (billions of 1996 dollars)	\$9,191.4	\$9,214.5	\$9,439.9	\$9,672.9	\$10,048.8
year-to-year growth	3.8%	0.3%	2.4%	2.5%	3.9%
Consumption (billions of 1996 dollars)	\$6,223.9	\$6,377.2	\$6,576.0	\$6,770.5	\$7,029.5
year-to-year growth	4.3%	2.5%	3.1%	3.0%	3.8%
Business fixed investment (billions of 1996 dollars)	\$1,324.2	\$1,255.1	\$1,183.4	\$1,203.2	\$1,308.4
year-to-year growth	7.8%	-5.2%	-5.7%	1.7%	8.7%
Change in business inventories (billions of 1996 dollars)	\$65.0	(\$61.4)	\$5.2	(\$6.9)	\$43.1
Residential investment (billions of 1996 dollars)	\$372.4	\$373.5	\$388.2	\$410.8	\$403.6
year-to-year growth	1.1%	0.3%	3.9%	5.8%	-1.7%
Government spending (billions of 1996 dollars)	\$1,582.5	\$1,640.4	\$1,712.8	\$1,772.2	\$1,803.7
year-to-year growth	2.7%	3.7%	4.4%	3.5%	1.8%
Net Exports (billions of 1996 dollars)	(\$398.8)	(\$415.9)	(\$488.6)	(\$553.8)	(\$601.7)
Exports (billions of 1996 dollars)	\$1,137.2	\$1,076.1	\$1,058.8	\$1,057.2	\$1,105.6
Imports (billions of 1996 dollars)	\$1,536.0	\$1,492.0	\$1,547.4	\$1,611.0	\$1,707.3
Personal income (year-to-year growth)	8.0%	3.3%	2.7%	2.7%	4.2%
Wage & salary income (year-to-year growth)	8.2%	2.4%	0.9%	1.9%	2.9%
Personal savings rate	2.8%	2.3%	3.7%	3.3%	3.2%
Capacity utilization rate	82.7%	77.3%	75.6%	75.8%	78.0%
Housing starts (millions of units)	1.569	1.603	1.711	1.732	1.651
Conventional mortgage rates	8.1%	7.0%	6.5%	5.7%	5.7%
Federal budget surplus (billions of dollars, NIPA basis)	\$224.8	\$40.7	(\$254.1)	(\$366.0)	(\$505.6)

In Michigan, economic activity will lag the national pickup considerably, primarily because of the employment situation (see Figures 2, 3, and 4). Inflation-adjusted personal income is expected to increase 3.3% in 2003 before increasing 3.8% in 2004, compared with a 2.5% increase in 2002. However, wage and salary employment is forecasted to fall 1.1% in 2003 and to grow only 0.7% in 2004. Such job growth represents an improvement from the 2.5% and 1.7% declines in wage and salary employment experienced in 2000 and 2001, respectively. Minimal growth in auto sales will combine with productivity improvements to keep unemployment rates around 7.1% and above the national average. The higher unemployment rate will combine with other economic factors to keep increases in Michigan prices slightly slower than the national average.

Compared with the May 2003 Consensus Economic Forecast, the U.S. economy is generally stronger while the Michigan economy is weaker. For example, the May estimates forecasted inflation-adjusted GDP to increase 2.2% in 2003 and 3.7% in 2004, compared with revised estimates of 2.5% and 3.9%, respectively. Light vehicle sales were estimated in May 2003 to total 16.0 million units in 2003 and increase to 16.5 million units in 2004, compared with a revised forecast of 16.6 million units in 2003 and 16.8 million units in 2004. However, the May 2003 forecast estimated that the U.S. unemployment rate would be 6.0% in 2003 and 5.7% in 2004, compared with revised estimates of 6.1% and 6.2%, respectively. For Michigan, the May forecast estimated that wage and salary employment would decline 0.7% in 2003 before rising 1.4% in 2004, compared with a revised estimate of a decline of 1.1% in 2003 and an increase of 0.7% in 2004. The May forecast also estimated that personal income would rise 3.1% in 2003 and 5.1% in 2004 and that the unemployment rate would decline from 6.5% in 2003 to 6.1% in 2004, compared with the revised estimate of personal income growth of 3.3% in 2003 and 3.8% in 2004 and unemployment rates of 7.1% in both years.

Figure 1

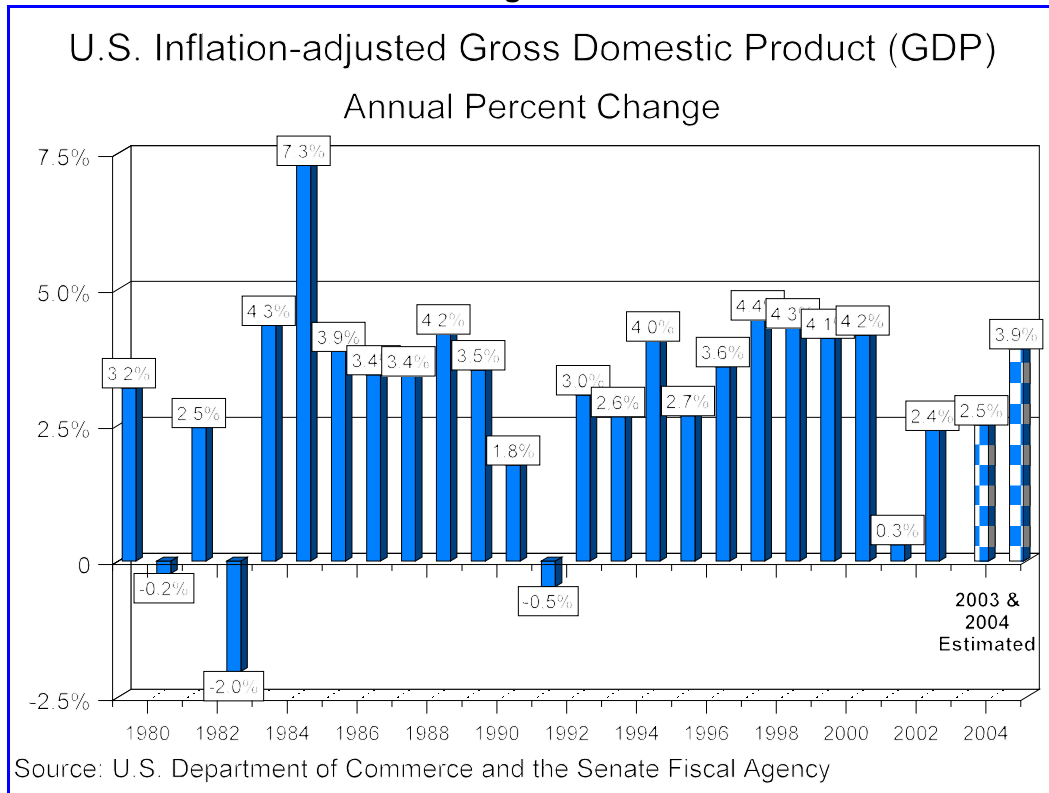


Figure 2

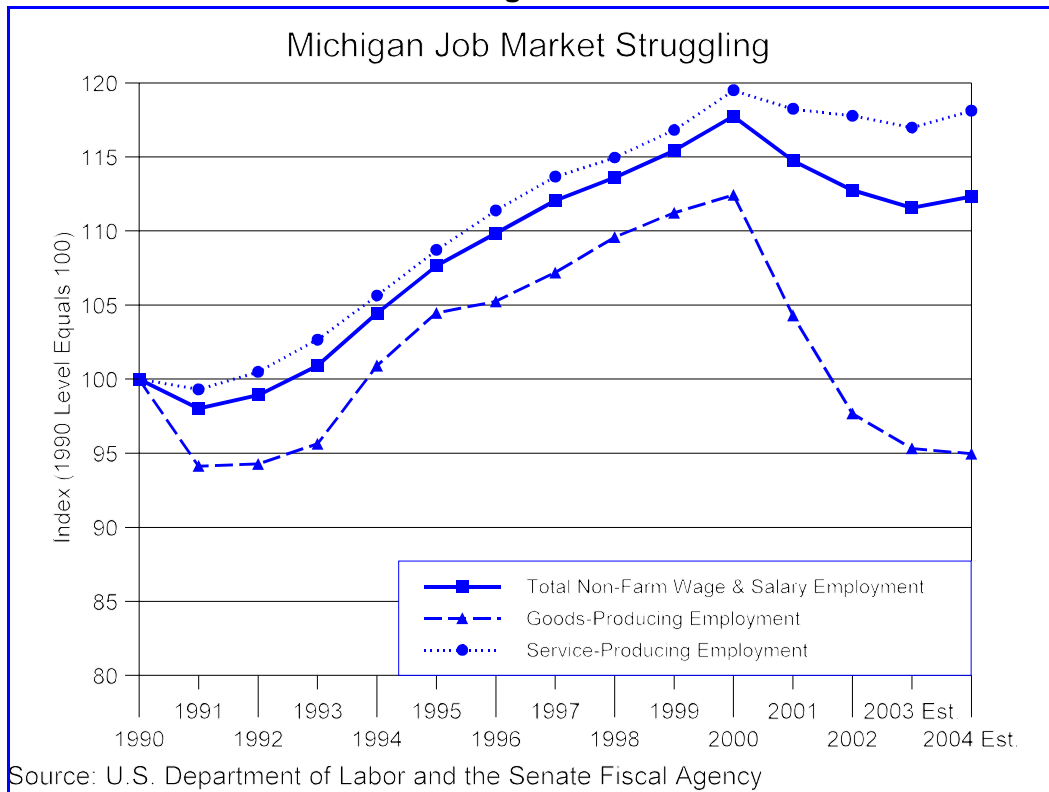


Figure 3

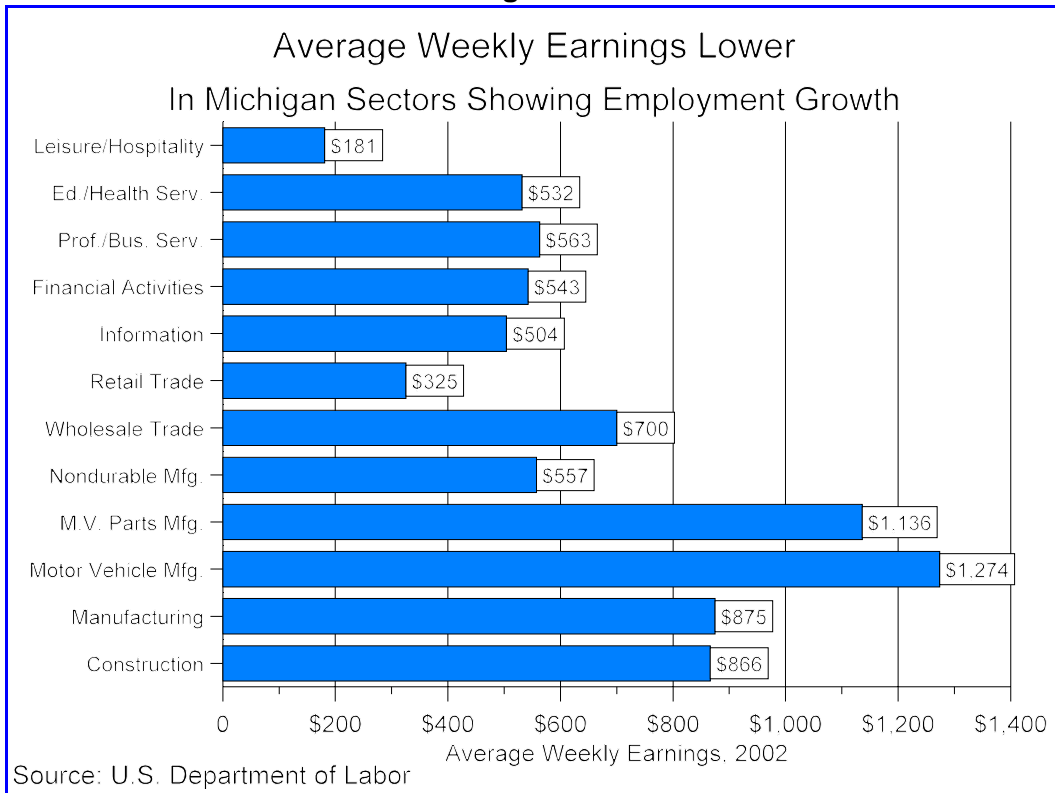
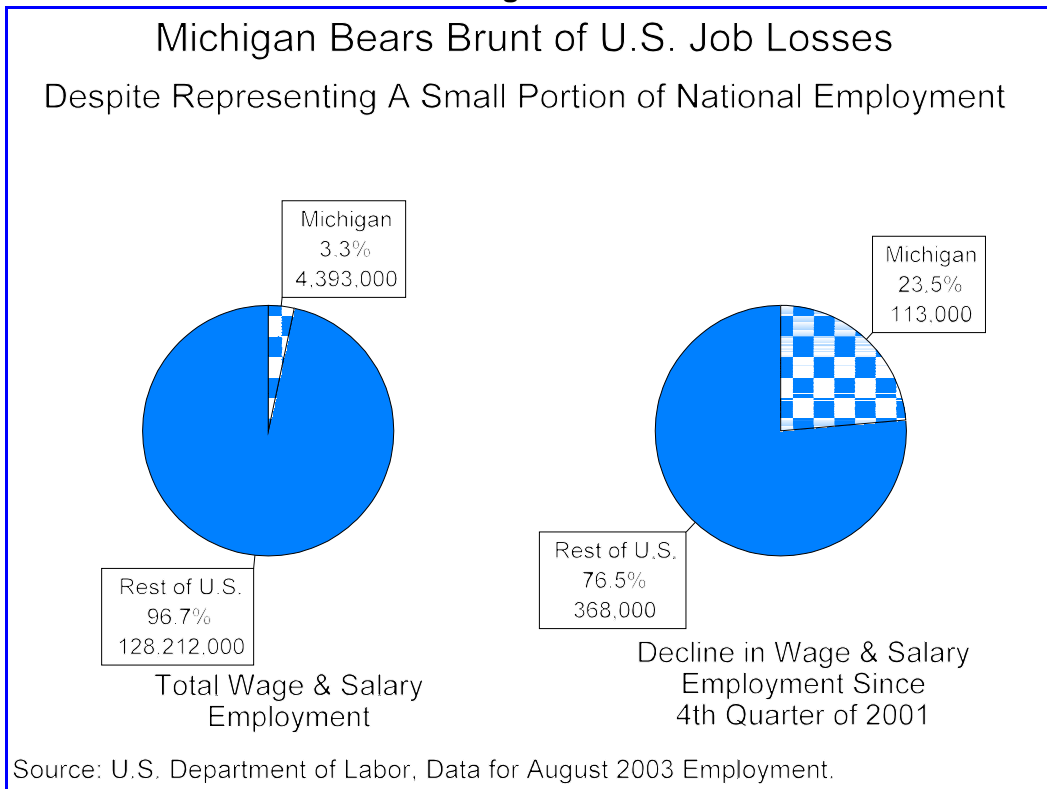


Figure 4



COUNTER-CYCLICAL BUDGET AND ECONOMIC STABILIZATION FUND

Table 3 presents the estimated balance of the Counter-Cyclical Budget and Economic Stabilization Fund (BSF) for FY 2002-03 and FY 2003-04.

FY 2002-03

In FY 2001-02, a record \$870.0 million was transferred out of the BSF, leaving an ending balance of \$145.2 million. No transfers into the BSF were appropriated in FY 2002-03, which marked the third consecutive year that no payments were made into the BSF. The beginning balance of \$145.2 million, together with an estimated \$1.9 million in interest earnings, will bring the balance in the Fund up to \$147.1 million. Two appropriations have been enacted to help balance the GF/GP and SAF budgets in FY 2002-03. A transfer of \$32.0 million was appropriated to the SAF to make payments to school districts under the *Durant* agreement, and \$115.1 million was appropriated to the General Fund/General Purpose budget. These transfers from the BSF will bring the balance at the end of FY 2002-03 to zero. This will mark the ninth time that the BSF has ended a fiscal year with a zero balance.

FY 2003-04

In FY 2003-04, the balance in the BSF will remain at zero. As originally enacted, the budget for FY 2003-04 included a contingency provision that would have required an estimated \$73 million transfer into the BSF as long as the beginning balance in the GF/GP budget carried over from FY 2002-03 was at least \$350 million. The SFA estimates that the FY 2002-03 ending balance will be well short of \$350 million, and therefore, no transfer will be made into the BSF in FY 2003-04 and the balance will remain at zero.

Table 3

ECONOMIC AND BUDGET STABILIZATION FUND TRANSFERS, EARNINGS AND FUND BALANCE FY 1999-2000 TO FY 2003-04 (millions of dollars)				
Fiscal Year	Pay-In	Interest Earned	Pay-Out	Fund Balance
1999-2000	\$100.0	\$73.9	\$132.0	\$1,264.4
2000-01	0.0	66.7	337.0	994.2
2001-02	0.0	20.8	869.8	145.2
Estimates				
2002-03	0.0	1.9	147.1	0.0
2003-04	0.0	0.0	0.0	0.0
Summary of Appropriated Pay-Outs:				
	FY 2000-01	FY 2001-02	FY 2002-03	
School Aid Fund:				
Durant Payments	\$32.0	\$32.0	\$32.0	
Other Withdrawal	0.0	350.0	0.0	
Subtotal SAF	\$32.0	\$382.0	\$32.0	
Trunkline Fund	35.0	35.0	0.0	
General Fund	270.0	452.8	115.1	
Total Pay-Outs	\$337.0	\$869.8	\$147.1	

REVENUE LIMIT

At the May 2003 Consensus Revenue Estimating Conference, it was estimated that revenues subject to the constitutional revenue limit would fall below the revenue limit by \$4.33 billion in FY 2002-03 and by \$4.78 billion in FY 2003-04. Given that the revised revenue estimates presented in this report have been reduced from the estimates agreed to in May 2003, the gap between revenues and the revenue limit is forecasted to be even wider in FY 2002-03 and FY 2003-04. It is estimated that revenues will fall below the revenue limit by \$4.56 billion in FY 2002-03 and by \$5.19 billion in FY 2003-04.

THE FORECAST FOR STATE REVENUES

This section of the Economic Outlook and Budget Review provides revised estimates of General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenues for FY 2002-03 and FY 2003-04. The overall revenue estimates for both FY 2002-03 and FY 2003-04 have been revised downward compared with the May 2003 consensus estimate. The revised estimates for FY 2002-03 are based largely on fiscal year-to-date actual collections through the preliminary data for September 2003, along with estimates of the amount of revenue that will be accrued back to FY 2002-03. These accruals generally will include collections in October and November that result from liabilities that were incurred before the end of FY 2002-03. The revised revenue estimates for FY 2003-04 reflect the revised economic forecast presented in the first section of this report and that FY 2003-04 tax collections are now being built off of a lower FY 2002-03 level.

FY 2002-03

General Fund/General Purpose and SAF revenues will total an estimated \$18.56 billion in FY 2002-03, which represents virtually no change from the total revenues in FY 2001-02. This revised revenue estimate is down \$289 million from the May 2003 consensus revenue estimates. Most of this downward revision in the revenue estimates is due to weaker-than-expected collections from the income, sales, use, and single business taxes. The revised estimates for FY 2002-03 are summarized in Table 4.

General Fund/General Purpose. General Fund/General Purpose revenue will total an estimated \$7.89 billion in FY 2002-03, which is 6.4%, or \$540 million, below the FY 2001-02 actual level. Baseline revenues, which reflect what revenues would have been had there been no changes to rate or base of any taxes, were down an estimated 2.0% in FY 2002-03, which represents the third consecutive year that baseline revenues have fallen below the previous year's level. Compared with the May 2003 consensus revenue estimates, the GF/GP revenue estimate has been lowered \$197 million. Most of this downward revision is due to lower-than-expected collections from the income tax, but revenue estimates for the single business, sales, and use taxes also were lowered.

School Aid Fund. Tax and lottery revenue earmarked to the School Aid Fund will total an estimated \$10.67 billion in FY 2002-03, which is up 5.3%, or \$541 million, from the final revenue in FY 2001-02. Most of this increase is due to the acceleration in the collection of the State education property tax, which will generate an estimated \$455 million in one-time revenue in FY 2002-03, and to an increase in the tobacco taxes (cigarette and other tobacco products taxes), which went into effect at the end of FY 2001-02. As a result, on a baseline basis, SAF revenues will be up only an estimated 0.2% in FY 2002-03. Compared with the May 2003 consensus revenue estimates, the estimate of SAF revenue in FY 2002-03 has been lowered \$91 million. Most of this downward revision is concentrated in the income, sales, and use taxes.

Table 4

FY 2002-03 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(dollars in millions)

	Change From FY 2001-02				
	FY 2001-02 Final	FY 2002-03 Revised Est.	Dollar Change	Percent Change	\$ Change from 5/03 Consensus
GEN'L FUND/GEN'L PURPOSE:					
Baseline Revenue	\$8,280.1	\$8,114.6	\$ (165.5)	(2.0)%	\$(199.2)
Tax Changes Not In Baseline	146.2	(227.9)	(374.1)	—	2.0
Revenue After Tax Changes:					
<u>Personal Income Tax</u>					
Gross Collections	7,542.4	7,385.7	(156.7)	(2.1)	(88.0)
Less: Refunds	(1,447.2)	(1,550.8)	(103.6)	7.2	(57.0)
Net Income Tax Collections	6,095.2	5,834.9	(260.3)	(4.3)	(145.0)
Less: Earmarking to SAF	(1,860.4)	(1,856.7)	3.7	(0.2)	22.1
Campaign Fund	(1.2)	(1.5)	(0.3)	25.0	0.0
Net Income Tax to GF/GP	\$4,233.6	\$3,976.7	\$(256.9)	(6.1)%	\$(122.9)
<u>Other Taxes</u>					
Single Business Tax	1,983.3	1,850.6	(132.7)	(6.7)	(45.0)
Sales	88.0	58.6	(29.4)	(33.4)	(21.6)
Use	868.3	812.1	(56.2)	(6.5)	(26.0)
Cigarette	194.2	286.6	92.4	47.6	3.3
Insurance Company Premiums	227.1	245.8	18.7	8.2	(5.0)
Telephone & Telegraph	137.3	132.2	(5.1)	(3.7)	0.0
Estate	131.0	102.3	(28.7)	(21.9)	0.0
Oil & Gas Severance	30.7	57.0	26.3	85.7	15.0
All Other	203.8	131.0	(72.8)	(35.7)	(10.0)
Subtotal Other Taxes	\$3,863.7	\$3,676.2	\$(187.5)	(4.9)%	\$(89.3)
Total Nontax Revenue	329.0	233.8	(95.2)	(28.9)	15.0
GF/GP REVENUE AFTER TAX CHANGES	\$8,426.3	\$7,886.7	\$(539.6)	(6.4)%	\$(197.2)
SCHOOL AID FUND:					
Baseline Revenue	10,105.3	10,123.6	18.3	0.2	(85.4)
Tax Changes Not In Baseline	28.6	550.7	522.2	1,827.4	(6.0)
Revenue After Tax Changes:					
Sales Tax	4,695.3	4,687.6	(7.7)	(0.2)	(53.5)
Lottery Revenue	613.5	588.0	(25.5)	(4.2)	0.0
State Education Property Tax	1,583.7	2,101.2	517.5	32.7	(16.0)
Real Estate Transfer Tax	253.1	260.0	6.9	2.7	0.0
Income Tax	1,860.4	1,856.7	(3.7)	(0.2)	(22.1)
Casino Tax	91.9	91.0	(0.9)	(1.0)	0.0
Other Revenue	1,036.0	1,089.8	53.8	5.2	0.2
SAF REV. AFTER TAX CHANGES	\$10,133.9	\$10,674.4	\$540.5	5.3%	\$(91.4)
BASELINE GF/GP AND SAF	18,385.5	18,238.2	(147.3)	(0.8)	(284.7)
Tax & Revenue Changes	174.8	322.8	148.0	84.7	(4.0)
GF/GP & SAF REVENUE AFTER CHANGES	\$18,560.3	\$18,561.0	\$ 0.7	0.0%	\$(288.7)
SALES TAX	\$6,439.9	\$6,431.1	\$(8.8)	(0.1)%	\$(73.0)

Note: Baseline revenue in this table is based on FY 2001-02 to provide an accurate comparison of the revenue.

FY 2003-04

General Fund/General Purpose and School Aid Fund revenues in FY 2003-04 will total an estimated \$18.32 billion, which is 1.3%, or \$246 million, below the revised estimate for FY 2002-03. The major reason for this decline is that the gain in revenue due to the expected improvement in economic activity in 2004, compared with 2003, will not be large enough to offset the one-time boost in FY 2002-03 revenues resulting from the acceleration in the due date of the State education property tax. Compared with the May 2003 consensus revenue estimates, FY 2003-04 GF/GP and SAF revenue estimates have been revised down \$592 million, due to both the downward revision in FY 2002-03 revenues, which gives FY 2003-04 revenues a lower base from which to grow, and a projected slower rate of economic growth than forecast in May 2003. The revised revenue estimates for FY 2003-04 are presented in Table 5.

General Fund/General Purpose. Tax and nontax revenue that goes into GF/GP revenue will total an estimated \$7.78 billion in FY 2003-04. This revised estimate represents a decrease of 1.4%, or \$109 million, from the revised estimate for FY 2002-03 revenues. The final phase in the five-year 0.5 percentage point cut in the income tax rate will reduce the income tax rate from 4.0% in 2003 to 3.9% on January 1, 2004. This rate change will reduce income tax revenue about \$113 million in FY 2003-04. Compared with the May 2003 consensus revenue estimate, the FY 2003-04 GF/GP revenue estimate has been lowered \$381 million. Over half of this downward revision occurred in the income tax, but single business and sales tax collections also were lowered significantly.

School Aid Fund. School Aid Fund revenue from earmarked taxes and the lottery will total an estimated \$10.54 billion in FY 2003-04. This represents a 1.3% decline from the revised estimate for FY 2002-03, but this loss reflects the fact that the FY 2002-03 SAF revenue benefitted from the one-time boost in State education property tax collections. Adjusting for the \$455 million one-time increase in State education property tax revenue in FY 2002-03, and all other enacted tax changes that will occur in FY 2003-04, baseline SAF revenue will increase 2.9% in FY 2003-04, largely due to the expected improvement in the level of economic activity. However, compared with the May 2003 consensus revenue estimates, the revised SAF revenue estimate is down \$211 million, due primarily to lower estimates for the sales and income taxes.

General Fund and School Aid Fund Taxes

Brief descriptions of the revised revenue estimates for some of the major General Fund and School Aid Fund taxes are presented below.

Income Tax. Net income tax collections are expected to decline 4.3%, or \$260 million, in FY 2002-03, compared with the FY 2001-02 level. This revised estimate is \$145 million below the May 2003 consensus revenue estimate. In FY 2003-04, net income tax collections will be down 1.2% or \$70 million, to \$5.77 billion. Compared with the May 2003 consensus revenue estimate, this revised income tax revenue estimate is down \$259 million. These downward revisions in the income tax revenue estimates are due primarily to the weak labor market, which continues to reduce the number of people with jobs. This decline in the employment level is not expected to turn around until the second half of FY 2003-04. About one-quarter of gross income tax collections goes into the SAF, and the remaining income tax revenue goes into the General Fund.

Sales Tax. Sales tax collections will total an estimated \$6.43 billion in FY 2002-03, which is down 0.1%, or \$9.0 million, compared with the FY 2001-02 final level. This revised sales tax estimate is \$73 million below the May 2003 consensus revenue estimate. The last time sales tax collections

declined from one year to the next was in FY 1981-82, when they declined 1.5%. In FY 2003-04, sales tax collections are expected to increase 4.0% to \$6.69 billion. This represents a \$146 million downward revision compared with the May 2003 estimate. About 73% of total sales tax revenue is earmarked to the SAF and up to 24% goes to local governments, with the remaining amount being split between the Comprehensive Transportation Fund, a special health program, and the General Fund.

Single Business Tax. Single business tax revenue will total an estimated \$1.85 billion in FY 2002-03, which represents a 6.7% decline from the FY 2001-02 level. This revised estimate for FY 2002-03 is down \$45 million from the May 2003 consensus estimate. In FY 2003-04, single business tax revenue is expected to total \$1.90 billion, a 2.7% increase from the revised FY 2002-03 estimate, but \$112.0 million below the May 2003 consensus estimate. All revenue from the single business tax is earmarked to the General Fund/General Purpose budget.

State Education Property Tax. State education property tax revenue will total an estimated \$2.1 billion in FY 2002-03, an increase of 32.7% from the FY 2001-02 level. This large increase is due to the \$455 million in one-time revenue that will be collected from the acceleration in the due date of the tax. Not including this one-time boost in revenue, State education property tax revenue will be up an estimated 4.0% in FY 2002-03. In FY 2003-04, State education property tax revenue will total an estimated \$1.75 billion, which represents a 16.6% decline from the FY 2002-03 level. Compared with the May 2003 consensus estimate, the State education property tax revenue estimate has been lowered \$11 million. All revenue from the State education property tax is earmarked to the SAF.

Table 5

FY 2003-04 REVISED REVENUE ESTIMATES
GENERAL FUND/GENERAL PURPOSE AND SCHOOL AID FUND
(dollars in millions)

			Change From FY 2002-03		
	FY 2002-03 Revised Est.	FY 2003-04 Revised Est.	Dollar Change	Percent Change	\$ Change from 5/03 Consensus
GEN'L FUND/GEN'L PURPOSE:					
Baseline Revenue	\$8,114.6	\$8,270.9	\$156.3	1.9%	\$(399.6)
Tax Changes Not In Baseline	(227.9)	(493.4)	(265.5)	116.5	18.4
Revenue After Tax Changes:					
Personal Income Tax					
Gross Collections	7,385.7	7,354.3	(31.4)	(0.4)	(200.0)
Less: Refunds	(1,550.8)	(1,589.2)	(38.4)	2.5	(59.0)
Net Income Tax Collections	5,834.9	5,765.1	(69.8)	(1.2)	(259.0)
Less: Earmarking to SAF	(1,856.7)	(1,897.1)	(40.3)	2.2	51.0
Campaign Fund	(1.5)	(1.5)	0.0	0.0	0.0
Net Income Tax to GF/GP	\$3,976.7	\$3,866.5	\$(110.1)	(2.8)%	\$(208.0)
Other Taxes					
Single Business Tax	1,850.6	1,901.0	50.4	2.7	(111.9)
Sales	58.6	126.5	67.9	115.9	14.1
Use	812.1	809.5	(2.6)	(0.3)	(73.3)
Cigarette	286.6	280.8	(5.8)	(2.0)	2.9
Insurance Co. Premiums	245.8	258.0	12.2	5.0	(5.0)
Telephone & Telegraph	132.2	128.8	(3.4)	(2.6)	0.0
Estate	102.3	70.0	(32.3)	(31.6)	(5.0)
Oil & Gas Severance	57.0	50.0	(7.0)	(12.3)	15.0
All Other	131.0	110.5	(20.5)	(15.6)	(10.0)
Subtotal Other Taxes	\$3,676.2	\$3,735.2	\$ 59.0	1.6%	\$(173.3)
Total Nontax Revenue	233.8	175.8	(58.0)	(24.8)	0.0
GF/GP REV. AFTER TAX CHANGES	\$7,886.7	\$7,777.5	\$(109.2)	(1.4)%	\$(381.3)
SCHOOL AID FUND:					
Baseline Revenue	10,123.6	10,419.1	295.5	2.9	(210.5)
Tax Changes Not In Baseline	550.7	119.0	(431.7)	(78.4)	(0.3)
Revenue After Tax Changes:					
Sales Tax	4,687.6	4,874.0	186.4	4.0	(107.1)
Lottery Revenue	588.0	581.0	(7.0)	(1.2)	(11.0)
State Education Property Tax	2,101.2	1,753.1	(348.1)	(16.6)	(11.0)
Real Estate Transfer Tax	260.0	253.0	(7.0)	(2.7)	(7.0)
Income Tax	1,856.7	1,897.1	40.3	2.2	(51.0)
Casino Tax	91.0	94.5	3.5	3.8	0.0
Other Revenue	1,089.8	1,085.4	(4.4)	(0.4)	(23.7)
SAF REV. AFTER TAX CHANGES	\$10,674.4	\$10,538.2	\$(136.2)	(1.3)%	\$(210.8)
BASELINE GF/GP AND SAF	18,238.2	18,690.0	451.8	2.5	(610.2)
Tax & Revenue Changes	322.8	(374.4)	(697.2)	—	18.1
GF/GP & SAF REVENUE AFTER CHANGES	\$18,561.0	\$18,315.6	\$(245.5)	(1.3)%	\$(592.1)
SALES TAX	\$6,431.1	\$6,687.1	\$256.0	4.0%	\$(146.0)
Note: Baseline revenue in this table is based on FY 2001-02 to provide an accurate comparison of the revenue					

ESTIMATE OF YEAR-END BALANCES

Based on the economic and revenue estimates outlined earlier in this report, along with enacted and projected State appropriations, the Senate Fiscal Agency (SFA) has revised its estimates of the FY 2002-03 and FY 2003-04 General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) year-end balances. The continuing weakness in the Michigan economy has resulted in significant downward revisions in estimated State revenues and led the SFA to estimate deficits in the FY 2003-04 GF/GP and SAF budgets. The Governor and the Legislature will be forced to explore options to eliminate these projected budget deficits over the next several weeks.

GENERAL FUND/GENERAL PURPOSE YEAR-END BALANCES

The State's FY 2002-03 fiscal year officially ended on September 30, 2003. The process of the final accounting of FY 2002-03 revenues and expenditures is still under way as many sources of State revenues collected after September 30, 2003, are accrued back to FY 2002-03. In addition, the final accounting of FY 2002-03 State expenditures will not be completed for several months. Based on actual and projected FY 2002-03 revenues and expenditures, the SFA now believes that the FY 2002-03 GF/GP budget will close the year with a \$48.4 million balance. Table 6 provides the details of this estimate. This estimate is based on the revised SFA estimate of FY 2002-03 GF/GP revenues, enacted revenue adjustments, enacted appropriations, a projected \$75.0 million pending supplemental appropriation to eliminate a shortfall in the State Medicaid program, and a projection of \$50.0 million of net year-end appropriation lapses. The actual final FY 2002-03 GF/GP year-end balance will carry forward and be available to support FY 2003-04 expenditures.

This estimated FY 2002-03 GF/GP year-end balance of \$48.4 million marks a significant downward revision from the previous SFA estimate of an FY 2002-03 GF/GP year-end balance of \$360.6 million. This \$360.6 million projected year-end balance was built into the revenue base of the enacted FY 2003-04 GF/GP budget. The downward revision of the year-end balance estimate results from reductions in the estimate of ongoing revenues, the inclusion of a \$75.0 million Medicaid supplemental appropriation, the elimination of \$69.5 million of GF/GP revenues from the sale of surplus State property in Northville, and changes in the SFA estimate of year-end appropriation lapses.

The downward revision of the amount of the FY 2002-03 GF/GP year-end balance carried forward into FY 2003-04, along with changes in the SFA estimate of FY 2003-04 GF/GP revenues and a projected \$75.0 million Medicaid supplemental appropriation, has led to a current SFA estimate of a \$584.8 million FY 2003-04 GF/GP budget deficit. This projected budget deficit equates to 6.5% of projected appropriations. Table 7 provides the details of this estimate.

Pursuant to provisions of Article V, Sec. 20 of the State Constitution of 1963, the Governor is required to submit to the Legislature a proposal to eliminate this projected budget deficit. It is assumed that this proposal from the Governor will be submitted to the Legislature following the October 14, 2003, meeting of the Consensus Revenue Estimating Conference, when the official estimate of State revenues will be established and the exact size of the FY 2003-04 GF/GP budget deficit will be determined. The options available to the Governor for the elimination of the projected budget deficit include any combination of appropriation reductions and revenue increases.

Table 6
FY 2002-03
General Fund/General Purpose
Revenues, Expenditures and Year-End Balance
(millions of dollars)

	Oct 2003 SFA Est.
Revenues:	
Beginning Balance	\$ 114.5
Ongoing Revenue Estimate	7,886.7
<u>Non Ongoing Revenue Adjustments:</u>	
Merit Award Trust Fund Transfer	151.3
Tobacco Settlement Trust Fund Transfer	14.6
Revenue Sharing Reductions	146.2
Liquor Purchase Revolving Fund-Fire Protection Grant Reduction	3.7
Transfer of Waterways Fund to GF (PA 746 of 2002)	7.8
Transfer of Pre-Funded Health Reserve to GF (PA 743 of 2002) ..	58.2
Hospital Assessment Revenue (PA 562 of 2002)	8.9
Sale of Surplus State Property-Northville	0.0
Investor Lawsuit Settlement	14.3
Vitamin Lawsuit Settlement	10.1
Tobacco Company Lawsuit Settlement	7.0
Revenue Sharing Reserve Account	195.6
Unrestricted Federal Aid	169.0
Federal Tax Reform State Revenue Impact	(6.0)
Federal Unemployment Benefits (Income Tax Revenues)	3.4
Budget Stabilization Fund Withdrawal (PA 504 of 2002)	115.1
Total Non-Ongoing Revenue Adjustments	899.2
Total Estimated Revenues	\$8,900.4
Expenditures:	
Original Enacted Appropriations	\$9,196.7
<u>Supplemental Appropriations:</u>	
Capital Outlay (Public Acts 530 & 560 of 2002)	(0.2)
Supplemental Appropriations (PA 746 of 2002)	(43.9)
Supplemental Appropriations (PA 39 of 2003)	(7.8)
Supplemental Appropriations (PA 173 of 2003)	(13.3)
School Aid Supplemental (PA 158 of 2003)	51.0
Executive Order 2002-22, GF/GP Spending Cuts	(227.2)
Executive Order 2002-22, Work Project Lapses	(2.8)
Executive Order 2003-3	(125.5)
Pending Medicaid Supplemental Appropriation	75.0
Projected Appropriation Lapses	(50.0)
Total Estimated Expenditures	\$8,852.0
Projected Year-End Balance	\$ 48.4

Table 7
FY 2003-04
General Fund/General Purpose
Revenues, Expenditures and Year-End Balance
(millions of dollars)

	Oct 2003 SFA Est.
Revenues:	
Beginning Balance	\$ 48.4
Ongoing Revenue Estimate	7,777.5
<u>Other Revenue Adjustments:</u>	
Transfer from Employment Security Fund (PA 84 of 2003)	10.0
Revenue Sharing Reductions	213.3
Tax Policy Changes	12.1
Sale of Property (Detroit Plaza Building)	2.0
Sale of Property (Northville State Hospital)	69.5
Transfer from Comprehensive Transportation Fund (PA 139 of 2003)	10.8
Unrestricted Federal Aid	169.0
Federal Tax Reform State Revenue Impact	(34.5)
Federal Unemployment Benefits (Income Tax Revenues)	8.0
Driver Responsibility Fee Legislation (PA 165 of 2003)	65.0
Drivers License Fee Legislation (PA 152 of 2003)	25.9
Total Other Revenue Adjustments	551.1
Total Estimated Revenues	\$8,377.0
Expenditures:	
Enacted Appropriations	\$8,655.2
Pending Capital Outlay Appropriations	231.6
Pending Medicaid Supplemental Appropriations	75.0
Projected Appropriation Lapses	0.0
Total Estimated Expenditures	\$8,961.8
Projected Year-End Balance	\$ (584.8)

SCHOOL AID FUND YEAR-END BALANCES

The revisions in the SFA estimates of FY 2002-03 and FY 2003-04 revenues also will have an impact on the projected balances in the SAF budget. A comparison of the current SFA estimates of FY 2002-03 and FY 2003-04 SAF revenues with enacted SAF appropriations leads to projected deficits in the SAF budget for both FY 2002-03 and FY 2003-04.

Table 8 provides the details of an SFA estimate of a \$90.0 million deficit in the FY 2002-03 SAF budget. Pursuant to Article V, Sec. 18 of the State Constitution of 1963, this year-end deficit will carry forward into FY 2003-04 and have an impact on the projected FY 2003-04 SAF year-end balance.

The combination of a \$90.0 million deficit carried forward from FY 2002-03 along with downward revisions in the SFA estimate of FY 2003-04 SAF revenues leads to a projected FY 2003-04 SAF deficit of \$318.5 million. Table 9 provides the details of this projected budget deficit. The Governor and the Legislature have several options that might be used to eliminate this projected

FY 2003-04 SAF deficit. A pro-rata reduction in SAF appropriations will take effect 30 days after the Governor notifies the Legislature that a pro-rata reduction is to be implemented, unless the Legislature enacts an alternative series of adjustments to eliminate the projected SAF deficit. A pro-rata reduction automatically reduces all SAF appropriations in a proportional amount to eliminate any projected SAF deficit. A pro-rata reduction to eliminate a \$318.5 million deficit would equate to a \$178 per-pupil reduction in State funding for all local school districts. This \$178 per-pupil reduction equates to a 2.7% reduction in the FY 2003-04 basic foundation allowance of \$6,700 per pupil. The second option available to the Governor and the Legislature to eliminate the projected SAF deficit would be any combination of revenue increases and appropriation reductions that would eliminate the deficit.

Table 8
FY 2002-03
School Aid Fund
Revenues, Expenditures and Year-End Balance
(millions of dollars)

	Oct 2003 SFA Est.
Revenues:	
Beginning Balance	\$ 237.0
Ongoing Revenue Estimate	10,219.7
<u>Non-Ongoing Revenue Adjustments:</u>	
State Property Tax Collection Date Change	454.7
Federal Tax Reform State Revenue Impact	(1.1)
Budget Stabilization Fund (Durant)	32.0
Total Non-Ongoing Revenue Adjustments	477.1
<u>Other Revenue Sources:</u>	
General Fund/General Purpose Grant	198.4
General Fund/General Purpose Grant (PA 158 of 2003)	51.0
Durant Bond Refinancing	0.0
Federal Unemployment Benefits (Income Tax Revenue)	0.9
Local Revenues	0.7
Federal Aid	1,219.8
Total Other Revenue Sources	1,470.8
Total Estimated Revenues	\$12,413.1
Expenditures:	
Enacted Appropriations (PA 121 of 2001)	\$8,128.4
Supplemental Appropriations (PA 191 of 2002)	4,563.5
Supplemental Appropriations (PA 521 of 2002)	18.5
Supplemental Appropriations (PA 158 of 2003)	(28.7)
Pro-Rata Reduction (February 2003)	(127.0)
Projected Appropriation Lapses	(51.6)
Total Estimated Expenditures	\$12,503.1
Projected Year-End Balance	\$ (90.0)

Table 9
FY 2003-04
School Aid Fund
Revenues, Expenditures and Year-End Balance
(millions of dollars)

	Oct 2003 SFA Est.
Revenues:	
Beginning Balance	\$ (90.0)
Ongoing Revenue Estimate	10,538.2
<u>Other Revenue Adjustments:</u>	
General Fund/General Purpose Grant	282.1
Federal Tax Reform State Revenue Impact	(5.4)
Federal Unemployment Benefits (Income Tax Revenues)	2.1
Proposed State Lottery Changes	50.0
Tax Policy Changes	4.4
Personal Property Tax Audits	8.5
School Bond Loan Refinancing	128.3
Total Other Revenue Adjustments	470.0
Federal Aid	1,316.7
Total Estimated Revenue	\$12,234.9
Expenditures:	
Enacted Appropriation (PA 521 of 2002)	\$12,696.9
Supplemental Appropriations (PA 158 of 2003)	(92.8)
Homestead Exemption Audit (PA 105 of 2003)	(50.7)
Projected Appropriation Lapses	0.0
Total Estimated Expenditures	\$12,553.4
Projected Year-End Balance	\$ (318.5)